State of North Carolina
Utilities Commission
Post Office Box 29510
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June 16, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, DC 20515

Dear Representative Dingell:

The North Carolina Utilities Commission welcomes the opportunity to respond to the questionnaire regarding electric industry restructuring that you sent on April 10, 1997.

Question 1. **Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?**

The North Carolina Utilities Commission currently has two dockets that deal with electric utility restructuring. The first, Docket No, E-100, Sub 77, which currently is being held in abeyance, was initiated in 1995 after a petition was filed by an industrial group requesting that the Commission initiate a proceeding to conduct an investigation of retail electric generation competition in North Carolina. By Order dated July 21, 1995, the Commission concluded that it should not initiate an adversarial proceeding, in large part because retail competition is not lawful under current North Carolina law and the legislature has not requested that such an investigation be conducted. Docket No. E-100, Sub 78 was initiated by the Commission to (1) study the impact of Federal Energy Regulatory Commission (FERC) Orders 888 and 889 on the North Carolina retail jurisdiction; (2) explore the probable impacts and likely consequences of greater wholesale competition on end-user rates; and (3) investigate ways to help bring the purported benefits of competition to each customer class with little or no diminution in levels of service and reliability within the current regulatory and statutory framework. Comments and reply comments have been filed by the parties, and further Commission action is pending. Neither docket has been closed.

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The North Carolina General Assembly recently passed Senate Bill 38, which is entitled, "An Act to Establish the Study Commission on the Future of Electric Service in North Carolina." This law provides for the appointment of 23 members to a Study Commission and directs that Commission to examine the cost, adequacy, availability, and pricing of electric rates and service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina. The Study Commission is directed to seek input and advice from the Utilities Commission and the Public Staff of the Commission, which represents the public before the Commission, and to obtain guidance by reviewing restructuring experiments in other states.

In the course of its study and in making recommendations, the Study Commission must fully address the following issues: fairness and equity among all customer classes; reliability of power supply; fair treatment of competing power providers; universal service; reciprocity between states; stranded investment - costs and benefits; clarification of state and federal jurisdiction; environmental impacts; alternative forms of regulation; the obligation to serve and to receive service; ways to eliminate or equalized subsidies and tax preferences; customer choice; functional unbundling; impact on low-income consumers; impact in renewable energy, conservation, and efficiency programs; impact on municipal utilities and rural electric cooperatives; and prevention of anticompetitive or discriminatory conduct or unlawful exercise of market power.

The Study Commission is empowered to contract for consultant services. It is required to make a report to the 1998 short session of the 1997 General Assembly, which may contain recommendations, and it is required to report the results of its study and its recommendations to the 1999 General Assembly.

Another bill related to retail competition was introduced during this session of the North Carolina General Assembly. House Bill 1127, which is entitled "Customer Choice in Electricity," would require the Utilities Commission to initiate a proceeding to restructure the electric utility industry, require the investor-owned utilities to file plans providing for customer choice, and provide for residential customer choice on or before October 1, 1998, commercial customer choice on or before January 1, 1999, and industrial customer choice on or before July 1, 1999. It also would require the investor-owned utilities to provide open access to their transmission and distribution facilities. In addition, it would provide for a system benefits charge to fund renewable energy resources, energy efficiency, and low-income assistance and allow partial recovery of stranded costs. It is not expected to be acted upon during this session and has been offered to the Study Commission as one example of how restructuring could occur.

Question 2. **Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?**

Neither the Utilities Commission nor the Public Staff of the Commission (the separate body that represents the interests of the using and consuming public in Commission proceedings) has asked Congress for any sort of legislation with respect to retail competition. The North Carolina Utilities Commission and the Public Staff do not support federal legislation mandating retail competition. The only area in which the North Carolina Commission has requested federal legislation is nuclear fuel storage, specifically with regard to the failure of the Department of Energy to be prepared to accept nuclear waste on January 1, 1998, as required by law.

Question 3. **Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?**

The Commission believes it currently has sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain. There are two areas in which questions may arise. The FERC has asserted jurisdiction over all transactions involving the investor-owned transmission systems. Large retail customers often are served directly through transmission-level facilities. If Congress enacts legislation, it should explicitly provide for state authority over the assignment of stranded costs to customers of this type. Secondly, because of the possibility a State's imposition of a non-bypassable fee to recover stranded costs could be challenged as a violation of the dormant Commerce Clause, Congress could confirm that States have this authority.

A related issue is the FERC's assertion of jurisdiction in Order 888A over costs stranded by retail-turned-wholesale customers (e.g., through municipalization), which is currently on appeal. Congress should confirm that the States have exclusive authority to address the recovery of retail stranded costs. Other than as described above, Congress should not address retail stranded cost issues because those issues are essentially local in nature and vary dramatically from utility to utility and from state to state.

Question 4. **Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978?**

While the North Carolina Commission and the Public Staff do not support federal legislation mandating competition, they believe that the Commission has the necessary authority to deal with such issues unless pre-empted by federal legislation. North Carolina law provides sufficient authority for the Commission and the Public Staff to inspect the books and records of affiliates to the extent they are directly or indirectly connected with the provision of public utility service in North Carolina. Whether the repeal of PUHCA would create gaps that state laws would need to fill is not clear at this time. In any event, the diversification standards in the Energy Policy Act of 1992 and the recently passed Telecommunications Act should be preserved and State oversight authority should not be restricted in any way.

Any repeal of PURPA should be undertaken within the context of consideration of adequate competition in the bulk power markets in a given State. The mandatory purchase requirements in Section 210 could be phased out in a way that makes the phasing out dependent upon the level of development of competitive solicitations or other competitive acquisition procedures for wholesale supplies.

Question 5. **Would any constitutional issues be raised by federal legislation:**

a. mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?

b. requiring states to conduct a proceeding on retail competition, reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?

Very significant constitutional issues are raised by both of these hypotheticals. The first one, however, is the more likely of the two to be found to be unconstitutional. The question raised is whether the Tenth Amendment is violated by presenting a State with the choice of adopting and implementing federal policies or exiting a field in which the States have historically exercised extensive regulatory authority and the federal government none. States were regulating the sale of both electricity and natural gas before there was

any federal regulation whatsoever. The United States Supreme Court fashioned a bright line between permissible and impermissible state regulation early in this century, in a series of cases involving natural gas. States were found not to have authority over wholesale sales, while their authority over retail sales was left undisturbed. This wholesale/retail line was applied to electric utilities in *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Company*, 272 U.S. 83 (1927), which prohibited states from regulating wholesale sales. As a direct result, Congress passed Part II of the Federal Power Act, which created and delegated authority to regulate wholesale electric sales to the Federal Power Commission (now the FERC). The main purpose of Congress' action was to "fill the gap" created by *Attleboro* and its predecessor cases. Supreme Court cases since that time have recognized that the regulation of public utilities is one of the most important of the functions traditionally associated with the police power of the States. See, e.g., *Arkansas Electric Co-op v. Arkansas Public Service Commission*, 461 U.S. 375 (1983), which upheld state regulation of wholesale sales that were exempt from the Federal Power Act.

Hypothetical (b) appears to be premised upon the approach taken in Title I of the Public Utility Regulatory Policies Act of 1978 (PURPA), which required the States to consider a number of substantive standards in accordance with procedural standards imposed by PURPA. A sharply divided Supreme Court upheld this approach in *FERC v. Mississippi*, 456 U.S. 742 (1982), noting that there was nothing in PURPA directly compelling the States to enact a legislative program. The dissent written by Justice O'Conner, which was joined by Justice (now Chief Justice) Rehnquist, strongly criticized the majority's approach and argued that Titles I and III of PURPA violate the Tenth Amendment because they address matters that are indisputably attributes of state sovereignty and they directly impede the States' ability to structure integral operations in areas of traditional governmental functions. The membership of the Court has changed substantially since this opinion was issued in 1982. Only one of the five-member majority is still on the Court, while both Justice O'Conner and Chief Justice Rehnquist of the four dissenters are still on the Court. Until the current Court issues more opinions in this area, the outcome of such an appeal cannot be determined.

Question 6. **From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?**

The problems created by a failure to grandfather prior state action depend in large part upon how a federal mandate differs from the action previously taken by each of the states. For instance, if a state has a longer phase-in period than the time limit contained in a federal mandate, enormous public confusion would result and there could be problems

obtaining sufficient quantities of materials and supplies (e.g., meters, software, additional computers, communications systems) and having trained personnel ready to install and repair them. The same effective date for all states would require all suppliers (generation, transmission, and distribution companies) to obtain the same materials, supplies, and manpower at the same time. This could increase equipment and manpower costs, which would diminish the benefits, if any, of the restructuring effort.

Question 7. **In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.**

a. Are you aware of any study or analysis relevant to your state that supports this conclusion?

b. Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.

(a) Neither the Commission nor the Public Staff is aware of any formal study or analysis related to the State of North Carolina on this issue. Discounted rates are illegal in North Carolina unless they are approved by the Utilities Commission and can be justified on the basis of differences in the level or type of service. The Commission approved self-generation deferral rate guidelines in 1994. Before a customer can obtain this type of rate, a substantial amount of data must be provided showing that (1) the customer has the ability and the financial incentive to self-generate; (2) the discounted rate more than covers the utility's marginal costs; and (3) the customer has given up part of the economic benefit it could have derived from self-generating in exchange for (a) not having to make the capital investment and (b) retaining the plant and fuel diversity of the utility's system by continuing to buy from the utility's grid. The incidence of these rates is not on the increase. Two self-generation deferral rates were approved in 1994, one in 1995, and one in 1997. To our knowledge there are no ongoing negotiations for any additional self-generation deferral rates.

(b) The table below shows the average industrial rate as a percentage of average residential rate for the four largest electric utilities under the jurisdiction of the North Carolina Utilities Commission by five year increments from 1970 through 1995 and for 1996. Historically, average industrial rates have been less than half to almost 70% of average residential rates.

Percent N.C. Industrial Average Rate
of Residential Average Rate

Year	CP&L	Duke	NPL	VEPCO
1970	54%	47%	51%	47%
1975	68	65	60	66
1980	69	66	62	69
1985	69	68	61	68
1990	68	62	61	67
1995	65	60	60	58
1996	64	60	59	56

The percentages increased from 1970 to 1985 mainly because of the addition of a substantial amount of nuclear (base load) generation during that time period.

North Carolina electric rates are cost based and there is little explicit subsidization. One customer class can subsidize another between rate cases if a utility's current investments are of a type that they would be assigned or allocated more to one class rather than to all classes (e.g. combustion turbines for meeting loads on peak). Because the North Carolina investor-owned utilities are no longer coming in regularly for rate cases, this type of inadvertent subsidization may be occurring more often. Most claims that industrial customers subsidize other classes are based on their disagreement with the method used to allocate utility costs. However, all of the methods used are based upon rational and reasonable assumptions.

In reviewing the performance of allocation methods over time in North Carolina, we can find no real pattern. We have informally observed class returns compared to the system return to see if one class has been disadvantaged. No clear pattern emerges because each allocation method is sensitive to uncontrollable factors which can severely

skew class returns. For example, the "single peak" method is extremely sensitive to the hour in which the peak load occurs (which is dependent on weather conditions at the time), and to a lesser degree the month in which it occurs. The "all energy" allocation method is sensitive to customer usage (again weather dependent) and the implementation of energy conservation measures.

One possible claim that one class subsidizes another class may result from the use of a dead-band around the system return for each class return when setting rates in a rate case. The use of this type of dead-band is justified by the inaccuracies contained within any allocation methodology. In North Carolina, a "plus or minus ten percent band" has been used around the system return as a target for each class return. Rates are typically set to produce class returns within a couple of percentage points of the system return. Exceptions to this can occur because of the need to avoid rate shock .

Question 8. **Although electricity rates very widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your state, and how they effect various customer classes.**

The tables set out on the following page show the average rates for the four largest electric utilities under the jurisdiction of the North Carolina Utilities Commission from 1990 through 1995, the latest year for which data is available. The general trend for North Carolina's two largest utilities, CP&L and Duke (which serve almost 95% of the retail customers served by the investor-owned utilities), has been generally downward. North Carolina has been one of the top five states for industrial growth in the nation during this period.

N.C. Residential - cents per kWh

Year	CP&L	Duke	NPL	VEPCO
1990	8.31	7.12	5.99	7.32
1991	8.37	7.13	6.00	7.58
1992	8.34	7.30	6.19	8.02
1993	8.31	7.35	6.59	8.43
1994	8.23	7.35	7.05	8.28
1995	8.03	7.30	7.09	8.28

N.C. Commercial - cents per kWh

Year	CP&L	Duke	NPL	VEPCO
1990	6.86	5.73	5.07	6.25
1991	6.94	5.72	5.21	6.09
1992	6.92	5.90	5.38	6.49
1993	6.89	5.82	5.53	6.78
1994	6.81	5.78	5.55	6.59
1995	6.61	5.77	5.59	6.62

N.C. Industrial - cents per kWh

Year	CP&L	Duke	NPL	VEPCO
1990	5.65	4.42	3.64	4.88
1991	5.69	4.41	3.81	4.65
1992	5.60	4.62	3.98	4.97
1993	5.58	4.46	4.10	5.10
1994	5.36	4.40	4.18	4.78
1995	5.19	4.40	4.26	4.78

Question 9. **Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility shareholders or the highest bidder?**

Whether or not a market is sufficiently competitive for the price to be determined solely by the market will vary from state to state and from region to region, and any determination as to the competitiveness of a given market should be made by the states. The potential for market abuse by incumbent utilities is a complex issue that cannot be resolved by the simple adoption of a federal policy in favor of competition. While federal antitrust laws can be used, State oversight will be essential to preventing or eliminating instances of market abuse.

The question assumes that all customers want choice and the elimination of regulation. The results of pilot programs so far clearly contradict that assumption. A New York utility recently conducted a pilot in which 10,000 residential customers were provided

information and requested to participate. Fewer than 300 were interested. The majority of commercial and small industrial customers also were not interested in participating. While the numbers are not as dramatic in New Hampshire, it had the same experience and that was with a pilot that guaranteed a minimum ten percent savings to all participants. Clearly if customers want to continue to purchase power at regulated rates on a bundled basis, a state should be able to allow customers to retain that option.

Proponents of the market-only approach also overlook or disregard the volatility such an approach engenders. Last winter natural gas market prices were very volatile (and high). The dramatic increases in rates that resulted as those high market prices were passed on to retail customers caused numerous complaints, which have spawned investigations into how to avoid such volatility in the future. There is no reason to suppose that customers, who are far less sophisticated than the purchasing departments of local distribution companies, will be able to avoid this type of volatility. In other states experimenting with natural gas retail customer choice programs, participating customers have had an entire year's worth of savings wiped out by one high-priced purchase during a peak period.

Volatility in the costs of electricity caused the postponement of at least one retail wheeling pilot. In November 1996, Commonwealth Electric Company in Massachusetts postponed its pilot program because of changing market conditions between the design and the implementation of the pilot. As designed, the pilot was expected to produce savings of around 15%. However, because of changes in the availability of nuclear plants and an increase in fuel prices (mainly natural gas), electricity prices would have increased approximately 5% for participants, rather than decreasing.

Question 10. **Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity," (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?**

The North Carolina Commission and the Public Staff do not know how many states have raised reciprocity as an issue. Reciprocity affects the interests of all stakeholders. If it is not imposed, the incumbent utility faces greater potential stranded costs, while the out-of-state utility can enjoy greater profits, while not facing any risks with respect to its own customers and potentially stranded costs. While the customers in the state imposing

the reciprocity requirement may be deprived of a potential supplier, they also are protected from the imposition of a higher transition charge or exit fee to recover higher stranded costs. States should have the flexibility to decide this issue without interference.

Question 11. If Congress were to require "unbundling" of local distribution company services as part of retail competition mandate, what practical problems might this present to state regulators?

If Congress required "unbundling" of local distribution company services, one problem might be that the typical residential customer would see a drastically different bill. For example, in most jurisdictions the residential customer's basic customer charge is typically one half or less than the costs that could be included in it. The difference is typically made up in the energy charge. As a result, lower energy users may pay somewhat less than their appropriate cost while high energy users may pay more. If changed, the lower users of electricity would see a higher portion of their bill as fixed and unable to be reduced by conservation, efficiency improvements, shifting usage periods or other means. In fact, it is possible that a low energy user's bill could actually increase after restructuring.

Another possible problem area would be meter ownership and accuracy. If the local distribution company is allowed to charge for its services on a per customer basis or contract load basis, it will not depend on the reading on a customer's meter for its services. Who then will own the meter: an electricity generator, the local distribution company, the customer, third party energy service companies, or a government authority? Who would verify that the meter is accurate? Who would be responsible for meter testing? Who would set the charges for meter testing? How quickly would a meter be checked after a customer requests such a check? Does the PUC have the authority to set standards for a meter testing business?

Meter reading and billing is another potential problem area. Would the local distribution company read the bill and perform all billing? Could an energy service company perform this function? Who would maintain the customer's billing history and how would this data be transferred between or among the companies doing the billing? If a customer made a partial payment of its bill, how would the payment be assigned between or among the service providers? What certification would be required of third party billing companies? Who would resolve a billing dispute between a customer and the billing agent? Would the answer be different if the agent is under contract to the customer? What if the agent is under contract to an energy service company located out of state?

Consumer education and consumer protection would be of paramount importance and would require additional personnel and a substantial amount of time.

Question 12. **Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?**

The North Carolina Commission does not have jurisdiction over public power entities, but North Carolina as a State has significant problems. North Carolina has two power agencies, which are groups of towns and cities that own a substantial amount of generation, particularly nuclear generation. These two power agencies appear on all of the lists as being in the group of the top five most vulnerable public power entities. North Carolina also is affected by federal power to the extent TVA is ultimately allowed to sell outside its boundaries.

Question 13. **How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?**

Based upon the impact of the restructuring of the telecommunications industry in North Carolina, federal legislation mandating competition by a near term date certain would increase the funding needs of both the Commission and the Public Staff. The advent of greater competition in the long distance market of the telephone industry has caused a very significant increase in the number of telephone complaints. The Public Staff handled 1,175 long distance companies complaints in 1995, compared to 445 complaints in 1994. In the last three years the Commission has doubled the number of its communication specialist positions and the Consumer Services Division of the Public Staff has had to increase its number of consumer analysts by 50% and secretarial staff by 100%.

It is likely that funds could be made available because the Commission and the Public Staff are funded through regulatory fees collected from all *public utilities* operating in North Carolina, based upon North Carolina jurisdictional revenues. The law allows the implementation of a temporary surcharge to avert a deficiency in funding. However, a statutory change might be necessary depending upon the final form of any restructured electric industry. This in turn could result in a delay in obtaining the necessary funds. If the funds are not available when needed there could be a precipitous decline in customer satisfaction and the overall quality of service received by the citizens of North Carolina.

Question 14. **What types of securitization plans have states adopted or considered as a means of providing for recovery of utility stranded assets? What risks and benefits are inherent in this approach, and who bears them?**

California has implemented a securitization plan, but we are unaware of its details. Pennsylvania has very recently approved securitization of a fairly small portion of PECO Energy Company's estimated stranded costs. PECO has estimated that it has $6.7 billion in stranded costs, of which it requested that it be allowed to securitize $3.6 billion. The Pennsylvania Public Utility Commission approved a plan that would recover $1.1 billion in potentially stranded costs through securitization. A variety of stakeholders have responded negatively to this decision.

The risks and benefits of securitization are not yet well understood. One concern we have is that this approach places too much of the risk on ratepayers. The level of stranded investment experienced by a utility cannot be calculated with any degree of specificity at any one point in time. Re-evaluating such calculations will be absolutely necessary to protect both ratepayers and shareholders. Securitization prevents that approach. Whether securitization could be used to recover a portion of stranded investment could be explored, but should be done on the state level.

Question 15. **There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.**

a. Do you believe PUHCA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?

PUHCA obviously affects competition and revisions to it are necessary. Revisions should be done carefully, however, because of the potential for market abuse.

b. Do you believe Congress should modify or repeal PUHCA? If so, why and under what if any conditions?

PUHCA probably needs to be revised at this point in time, but not repealed. At this point in time, the electric industry on the retail level has not changed sufficiently for

PUHCA to be repealed without some provision being made for the protection of the public. Any revisions should be done in the context of broader restructuring principles.

c. Should Congress enact legislation to modify the holding in Ohio Power Co. v. FERC, 954 F.2d 779 (D.C.Cir. 1992)?

Yes. Such legislation should make it clear that the FERC has the authority to address the pass-through of affiliated costs in wholesale rates (regardless of the actions taken by the Securities Exchange Commission) and that the states are not pre-empted from regulating affiliated costs to be passed through in retail rates. Such legislation should expressly provide that the FERC's authority is not being increased at the expense of the States with respect to retail ratemaking decisions.

Thank you again for the opportunity to participate.

Sincerely,

Jo Anne Sanford

Jo Anne Sanford
Chair